

Message Text

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PAGE 01 EC BRU 01575 171935Z

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E.O. 11652: GDS

TAGS: EFIN, EEC

SUBJECT: EC CENTRAL BANK GOVERNORS MEETING--COMMISSION OFFICIALS
REPORT ON RESULTS

REF: A) EC BRUSSELS 666, B) 75 EC BRUSSELS 10957

1. SUMMARY: COMMISSION OFFICIALS HAVE INFORMED US OF THE RESULTS OF EC CENTRAL BANK GOVERNORS' MEETING IN BASLE ON FEB. 9. THE GOVERNORS WILL GIVE PRIORITY TO MAINTAINING THE COHESIVENESS OF THE EUROPEAN MONETARY SNAKE, WHICH, IF NECESSARY, MEANS LARGE INTERVENTIONS IN EC CURRENCIES AND INCREASED USE OF CREDIT LINES, ESPECIALLY BETWEEN THE FRG AND FRANCE. SOME COMMISSION OFFICIALS BELEVE, HOWEVER, THAT THERE RATES ARE INHERENTLY UNSTABLED AND WILL HAVE TO BE CHANGED AT LEAST IN THE MEDIUM TERM. MONETARY POLICY SEEMS TO BE CONSISTENT WITH ECONOMIC GROWTH RATES, EXCEPT PERHAPS FOR ITALY, BUT LITTLE PROGRESS WAS MADE IN COORDINATING MONETARY POLICY. ARRANGEMENTS TO SMOOTH OUT DOLLAR RATE FULCTUATIONS CONTINUE TO WORK SATISFACTORILY.
END SUMMARY.

2. INTERVENTION ARRANGEMENTS: THE EC CENTRAL BANK
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 EC BRU 01575 171935Z

GOVERNORS ADOPTED A REPORT ON EXCHANGE MARKET INTER-

VENTIONS ALONG THE LINES OF THE WORKING GROUP PROPOSAL DESCRIBED IN REF B. THE CENTRAL BANKS WILL INTERVENE IN BOTH DOLLARS AND EC CURRENCIES, BUT PRIORITY WILL BE GIVEN TO KEEPING THE SNAKE CURRENCIES WITHIN THEIR MARGINS. THUS, SHOULD DOLLAR INTERVENTIONS ADVERSELY AFFECT THE COHESIVENESS OF THE SNAKE, BANKS WOULD RELY PRIMARILY ON CURRENCY INTERVENTIONS. THE FRENCH AND FRG GOVERNORS AGREED TO EXTEND FULLY THE VERY SHORT TERM LINES OF CREDIT AVAILABLE TO SNAKE MEMBERS. THE BANK OF FRANCE HAS DRAWN HEAVILY ON THEIR CREDITS IN ITS RECENT DM INTERVENTIONS.

3. DM REVALUATION: GOVERNOR KLASSEN SAID THE FRG HAD NO INTENTION OF REVALUING THE DM BECAUSE OF CONCERNS OVER THE IMPACT ON GERMAN EXPORT INDUSTRIES AND UNEMPLOYMENT. COMMISSION FINANCE OFFICIALS BELIEVE THAT THE INTENTION TO HOLD THE DM RATE CREATES AN INHERENTLY UNSTABLE CONDITION FOR THE SNAKE WHICH CAN ONLY LEAD TO FURTHER SPECULATION AND AN EVENTUAL CHANGE IN EXCHANGE RATES. THEY NOTE THE FRG IS PURSUING THREE POLICY OBJECTIVES: 1) IT IS MAINTAINING AN UNDERVALUED EXCHANGE RATE VIS-A-VIS MOST OTHER SNAKE CURRENCIES; 2) IT IS HOLDING DOWN DOMESTIC INTEREST RATES IN ORDER TO DAMPEN DOWN CAPITAL INFLOWS AND TO PROMOTE DOMESTIC INVESTMENT; AND 3) IT IS RELUCTANT TO TAKE SUFFICIENT EXPANSIONARY MEASURES TO REDUCE ITS PROJECTED BOP SURPLUS AND THEREBY EASE THE GROWING DEFICITS OF SOME OF ITS PARTNERS. THE FIRST AND THIRD OBJECTIVES ARE INCOMPATIBLE.

4. FF PROBLEMS: THESE OFFICIALS ADD THAT THE FF, ON THE OTHER HAND, IS OVERVALUED ESPECIALLY VIS-A-VIS THE DM. SINCE THE FREE FLOATING OF THE LIRE IN JANUARY, FRENCH INTERVENTIONS HAVE COST AN EQUIVALENT OF \$1.5-\$2 BILLION. AD HOC MEASURES MAY STABILIZE THE MARKET TEMPORARILY BUT IN THE MEDIUM TERM ONLY A CHANGE OF SAY 8 TO 12 PERCENT IN THE DM AND FF RATES WOULD RESTORE EQUILIBRIUM. THEY ADD GISCARD MADE A MISTAKE TO RETURN TO SNAKE AT THE RATE AT WHICH THE FF LEFT THE SNAKE. HE IS NOW RELUCTANT TO ADMIT THIS

CONFIDENTIAL

PAGE 03 EC BRU 01575 171935Z

MISTAKE BUT EVENTUALLY MARKET PRESSURE WILL FORCE HIM TO DO SO.

5. MONETARY POLICY OBJECTIVES: THE GOVERNORS DISCUSSED THEIR RESPECTIVE 1976 OBJECTIVES FOR MONETARY EXPANSION. THE BUNDESBANK HAD THE ONLY FIXED MONETARY TARGET: AN 8 PERCENT EXPANSION OF BANK NOTES IN CIRCULATION PLUS COMPULSORY MINIMUM BANK RESERVES AS

A PROPORTION OF BANK DOMESTIC LIABILITIES. THE OTHER GOVERNORS CITED NO FIXED TARGETS BUT ESTIMATED THEIR EXPECTATIONS FOR MONEY SUPPLY GROWTH BASED ON MONEY IN CIRCULATION, PLUS TIME DEPOSITS (I.E. M-2): THE NETHERLANDS, 12 PERCENT; IRELAND, 20 PERCENT; BELGIUM, 15 PERCENT, FRANCE, 16.5 PERCENT; AND DENMARK, 11 PERCENT. THE UK DID NOT PROVIDE AN ESTIMATE. ITALY FORESAW A 20 PERCENT EXPANSION IN MONEY SUPPLY BASED ON MONEY IN CIRCULATION, PLUS OTHER ASSETS WHICH CAN IMMEDIATELY BE CONVERTED TO MONEY SUCH AS CENTRAL BANK AND TREASURY DEPOSITS. THE COMMITTEE THOUGHT THE ITALIAN FORECAST WAS TOO EXPANSIONARY.

6. THE GOVERNORS DIRECTED A WORKING GROUP TO CONTINUE TO STUDY THE COORDINATION OF MONETARY POLICIES. THE BANKS DIFFERED, HOWEVER, OVER WHICH MONETARY AGGREGATES WOULD BE EMPHASIZED. THESE DIFFERENCES IMPEDE EFFECTIVE COORDINATION. THE GOVERNORS AGREED, HOWEVER, THAT THEIR RESPECTIVE MONETARY POLICIES WERE GENERALLY CONSISTENT WITH THE OBJECTIVE OF ACHIEVING STEADY BUT MODERATE ECONOMIC GROWTH THIS YEAR.

7. REPORT ON EXCHANGE MARKETS: THE GOVERNORS SUBMITTED A REPORT ON EXCHANGE MARKET DEVELOPMENTS TO THE EC FINANCE COUNCIL (SEE REF A). THIS REPORT INDICATED THAT INTERVENTIONS TO SMOOTH OUT THE DOLLAR RATE FLUCTUATIONS CONTINUE TO OPERATE SATISFACTORILY. DESPITE TURBULENT CONDITIONS, THE DAILY DOLLAR RATE VIS-A-VIS SNAKE CURRENCIES HAS GENERALLY NOT FLUCTUATED BY MORE THAN ONE PERCENT. COMMISSION OFFICIALS REPORT THAT THE GOVERNORS CONTINUE TO ASSUME THAT THE SECOND AND THIRD-TIERS FOR COORDINATION OF INTERVENTIONS THAT WERE PROPOSED AT RAMBOUILLET WILL NOT BE IMPLEMENTED. HINTON
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PAGE 04 EC BRU 01575 171935Z

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